No. 13,147

In the United States Court of Appeals for the Ninth Circuit

ESTATE OF MABEL COCHRAN, DECEASED; SIDNEY ELMER COCHRAN AND DONALD ROBERT COCHRAN, EXECUTORS, AND JOSEPH E. COCHRAN, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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v.

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OPINION BELOW

The unreported memorandum findings of fact and opinion of the Tax Court are printed in the record at pp. 186-193.

JURISDICTION

This appeal involves deficiencies in federal income tax asserted against Joseph E. Cochran (herein sometimes referred to as the taxpayer) for the calendar years 1943 and 1944 in the respective amounts of $10,078.72 and $8,619.36, and similar deficiencies asserted against the estate of his deceased wife, Mabel

Cochran, for the calendar years 1943 and 1944 in the respective amounts of \$9,468.67 and \$8,005.14.[1] (R. 187.) The Commissioner of Internal Revenue duly issued his statutory notices asserting these deficiencies under date of October 17, 1949. (R. 7-8, 10, 12, 14.) Separate petitions for review by the Tax Court of the Commissioner's determinations were duly filed with the Tax Court on December 27, 1949, pursuant to Section 272 of the Internal Revenue Code. (R. 7-10, 11-14.) The cases were consolidated for hearing and decision by the Tax Court. (R. 187.) The decisions of the Tax Court affirming the Commissioner's determinations were entered July 16, 1951. (R. 193, 194.) The case is brought to this Court by a joint petition for review of the Tax Court's decisions filed by the taxpayer and the executors of his deceased wife's estate (who, in conjunction with the taxpayer, are herein sometimes referred to as the taxpayers) on October 8, 1951. (R. 195-198.) The jurisdiction of this Court is invoked under Section 1141(a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTION PRESENTED

Whether the finding of the Tax Court that for the years 1942, 1943 and 1944 taxpayers' daughters were not for federal income tax purposes bona fide members of the partnership Cochran & Celli is clearly erroneous.

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[1] Computation of the deficiencies for 1943 also involves the income of the taxpayer and his deceased wife for 1942 by reason of the tax forgiveness provisions of Section 6 of the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126.

STATUTE INVOLVED

Internal Revenue Code:

Sec. 22. Gross Income.

(a) [As amended by Sec. 1, Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.* —"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * *

(26 U.S.C. 1946 ed., Sec. 22.)

Sec. 181. Partnership Not Taxable.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U.S.C. 1946 ed., Sec. 181.)

Sec. 182. Tax of Partners.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

(26 U.S.C. 1946 ed., Sec. 182.)

Sec. 3797. Definitions.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(26 U.S.C. 1946 ed., Sec. 3797.)

STATEMENT

This case was submitted to the Tax Court on a stipulation of facts (R. 18-23) found by the Tax Court as stipulated (R. 187), supplemented by documentary evidence (R. 24-76, 88-92) and the oral testimony of several witnesses (R. 94-184).

For a number of years prior to December 31, 1937, the taxpayer and Bernardo Celli, Sr., owned and operated as copartners a Chevrolet automobile dealership in Oakland, California, under the firm name of Cochran & Celli. On December 31, 1937, Mabel Cochran was the

wife of the taxpayer and Anna Celli was the wife of Bernardo Celli, Sr. The partnership interest of the taxpayer and Bernardo Celli, Sr., in the firm of Cochran & Celli constituted community property of the partners and their wives under the laws of California. (R. 18-19, 188.)

Also, on December 31, 1937, the taxpayer and Mabel Cochran had four children, Bernice M. Cochran (who is married and herein sometimes referred to as Bernice C. Johnson), Winifred Cochran (also since married and herein sometimes referred to as Winifred C. Irwin), and Sidney Elmer Cochran, all adults, and Donald Robert Cochran, who was then seventeen years of age. Bernardo Celli, Sr., and his wife, Anna Celli, had two children, Bernardo Celli, Jr., and Lloyd Celli, both of whom were adults. In 1937 the two adult sons of the Cellis were employed in the partnership business, as was Sidney, the adult Cochran son. (R. 19, 189.)

On December 31, 1937, the opening credit balances of the taxpayer and Bernardo Celli, Sr., on the books of the Cochran & Celli partnership were $242,914.94 and $237,605.44, respectively. As of that date journal entries were made transferring $100,617.43 from the investment account of the taxpayer to a new account set up in the name of Mabel Cochran and transferring $102,024.88 from the Bernardo Celli, Sr., investment account to a new account set up in the name of Anna Celli. As of the same date other entries were made transferring amounts from each of the four parents to each of their respective adult children. Attached as Exhibits 1 through 6 to the stipulation of facts (R. 19-20, 24-29) are excerpts from the investment accounts

in the names of the taxpayer, his wife, and their four children on the books of the partnership showing entries relating to transfers from one investment account to another during the period from December 31, 1937, to December 31, 1944, inclusive. In addition to the above transfer of $100,617.43 from the investment account of the taxpayer to the investment account in the name of his wife on December 31, 1937, these exhibits show that on the same date, December 31, 1937, there were transferred from the investment account of the taxpayer and also from that of his wife the sum of $16,818.21 as a credit to the investment account set up in the name of each of their three adult children; that as of March 31, 1941, there were transferred from the investment accounts of the taxpayer, his wife, and each of their three adult children, as a gift to Donald R. Cochran (who had just attained his majority), the sum of $4,000, which amounts were set up in the investment account opened in the name of Donald R. Cochran as his initial cash contribution to the partnership capital; that as of March 31, 1942, there were transferred from the investment accounts of the taxpayer, his wife, and each of their three older children, as a further gift to Donald R. Cochran, the sum of $4,000, which amounts were credited to the investment account of Donald R. Cochran as a further cash contribution to the capital of the partnership; that as of December 31, 1942, there were transferred from the investment account of the taxpayer and also from that of his wife, as a gift to each of their four children, the sum of $4,000, which amounts were credited to the investment account of the respective donees; that as of January 31,

1943, there were transferred from the investment account of the taxpayer and also from that of his wife, as a gift to each of their four children, the sum of $3,000, which amounts were credited to the investment account of the respective donees; that as of the same date, January 31, 1943, there were transferred from the investment account of each of the taxpayer's three older children, as a gift to Donald R. Cochran, the sum of $2,500, which amounts were credited to the investment account of Donald R. Cochran as cash paid in to the capital of the partnership; and that as of April 30, 1944, there were transferred from the investment account of the taxpayer and from that of his wife, as a gift to each of their four children, the sum of $3,000, which amounts were credited to the investment account of the respective donees as cash paid in. (R. 24-29.)

The above transfers on the books of the Cochran & Celli partnership were made as a part of a preconceived plan (R. 190), a part of which was the execution of a new partnership agreement under date of January 1, 1938, by the taxpayer and his wife, Bernardo Celli, Sr., and his wife, and all of the adult children of both families, for the continued conduct of the partnership business of Cochran & Celli under the same name.[2] This partnership agreement (a copy of which is attached as Exhibit 7 to the stipulation of facts (R. 20-21,

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[2] The Tax Court found from the evidence (R. 190) that the withdrawals from the taxpayer's investment account, the credits to his wife's new investment account, the crediting of new investment accounts of the Cochran daughters, Bernice and Winifred, and their signing of the partnership agreement all took place within the months of November and December, 1937, and were all component parts of a single plan to make all members of the Cochran family copartners in the business.

29-43)) is very comprehensive in its terms. It recited the ownership by the contracting parties of the business theretofore conducted under the firm name and style of Cochran & Celli, and that the new partnership would continue to conduct the business under the same firm name, assuming all valid obligations, liabilities, or contracts of the business theretofore owned and conducted by the taxpayer and Bernardo Celli, Sr. The percentage of their respective contributions and their interest in the business were stated to be as follows (R. 30):

Name	Interest
J. E. Cochran	19.11%
Mabel Cochran,	10.44%
Bernice M. Cochran	7.00%
Winifred Cochran	7.00%
Sidney Elmer Cochran	7.00%
Bernardo Celli, Sr.	18.22%
Anna Celli	11.23%
Bernardo Celli, Jr.	10.00%
Lloyd Celli	10.00%

Among the more important provisions of the agreement of January 1, 1938, paragraph 4 (R. 31) provided for the inclusion of Donald Robert Cochran in the partnership upon his attaining legal age. Paragraph 5 (R. 31-32) gave to the taxpayer and Bernardo Celli, Sr., as "Managers", absolute and unqualified control of all phases of the partnership business, and paragraph 9 (R. 35) provided for perpetuation of this joint control by the two families in the event of the death of either manager by designating as his successor "Manager" the oldest surviving male partner of the deceased's family. The agreement was to continue for

one year, and on a year to year basis thereafter unless some partner gave written notice in advance of his desire to dissolve the partnership. See paragraph 12 (R. 36). Other provisions, not particularly material here, related to continuation of the business in the event of the death of a partner, the right of a partner to withdraw from the partnership and the right of the remaining partners to acquire his interest, dissolution, etc. Paragraph 24 (R. 42) provided that title to the real property owned by the partnership should be held in trust by Bernardo Celli, Jr., and Sidney Elmer Cochran for the benefit of the partnership, and a declaration of trust to that effect was executed by them as of January 1, 1938 (R. 21, 52-59).

On or about February 28, 1945, the parties to the agreement of January 1, 1938, and Donald Robert Cochran executed a document entitled "Amendment to Articles of Co-Partnership" (R. 21, 43-52) which, among other things, confirmed the participation of Donald Robert Cochran as a partner beginning in 1941 and set out a revised statement of the purported partnership interest of each signatory for the years 1938 to 1943, inclusive.

On March 15, 1938, the taxpayer and his wife each filed a federal gift tax return for the calendar year 1937 in which each reported gifts under date of December 24, 1937, in the respective amounts of $16,818.21 to each of their three adult children, describing such gifts as "(3½%) J.E.C. interest in Partnership Cochran & Celli." On these returns each claimed an exclusion of $15,000 and a specific exemption of $35,454.63, and reported no tax due and paid no tax thereon. All subse-

quent purported gifts of partnership interest mentioned above were arranged in such amounts and made at such times as to preclude any gift tax liability. (R. 20, 189-190.)

In its findings of fact, which were based upon the oral testimony as well as the stipulation and exhibits, the Tax Court found, among other things, that (R. 189-191):

> In order to perpetuate the Chevrolet franchise in their families and to interest their sons in staying in the business, the two partners decided in 1937 to take their sons into the business as copartners.
>
> Under the new partnership agreement, dated January 1, 1938, not only the sons, but also Mabel Cochran, the wife of Joseph E. Cochran, Anna Celli, the wife of Bernardo Celli, Sr., and the Cochran daughters, Bernice and Winifred, were to be copartners in the business. The two Cochran daughters were included because their father felt morally obligated to give them as much as he gave his sons. There was also an understanding among the families that Donald Cochran was to become a partner when he reached his majority.
>
> Under the new partnership agreement no additional capital was at any time invested in the business by any of the copartners. The source of the capital investments of the new copartners, who were members of the Cochran family, were withdrawals from the Joseph E. Cochran investment account. Such transfers were at all times treated by Joseph E. Cochran as gifts of interest in the business and in making them he took advantage of the community property laws of the State of Cali-

fornia by first crediting his wife's new investment account with a substantial part of the withdrawal from his account, and then spreading out over a period of years the transfers to the Cochran children of portions of his own and his wife's investments in the business, so that he and his wife filed gift tax returns for the year 1937 only and reported no gift tax due. When Donald Cochran was brought into the business as a copartner in 1941, his capital investment account was similarly set up as a result of transfers of capital from the accounts of his parents, brother and sisters in accordance with a verbal understanding existing at the time Sidney, Bernice and Winifred acquired their interests in the business.

* * * * *

The new partnership was managed by the two original partners, assisted by their sons. The Cochran daughters neither shared in the management or control of the new partnership, nor did they render any services to the business. In 1942, 1943 and 1944 both daughters made regular withdrawals of money from the accumulated profits of the partnership credited to their accounts.

There was no bona fide intent on the part of the copartners of Cochran & Celli and the two Cochran daughters, Bernice and Winifred, either when the partnership was formed or at any other time during the taxable years 1942, 1943 and 1944, that the two Cochran daughters were to be joined with members of the existing partnership of Cochran & Celli for the purpose of carrying on business as a partnership. Bernice Cochran Johnson and Winifred Cochran Irwin were not valid partners for income tax purposes in the business of Cochran & Celli during the years 1942, 1943 and 1944.

The taxpayer, his deceased wife, Mabel Cochran, and their daughters, Bernice Cochran Johnson and Winifred Cochran Irwin, each filed individual federal income tax returns for the calendar years 1943 and 1944 on which they reported gross income, income from the partnership of Cochran & Celli, net income, and income tax due, in the following amounts (R. 22-23, 188):

	Gross Income	Income from Partnership	Net Income	Tax Due
1943				
J. E. Cochran..........	$20,777.36	$20,777.36	$19,756.31	$8,822.06
Mabel Cochran.........	15,977.36	15,977.36	15,325.13	6,701.60
Bernice C. Johnson......	16,912.12	14,202.09	16,638.60	5,584.98
Winifred C. Irwin.......	15,910.30	14,202.09	15,605.32	5,481.02
1944				
J. E. Cochran..........	$20,370.77	$20,370.77	$19,832.73	$7,467.23
Mabel Cochran.........	15,570.77	15,570.77	15,039.85	4,949.93
Bernice C. Johnson......	16,259.16	13,840.71	15,759.16	4,839.58
Winifred C. Irwin.......	15,551.95	13,840.70	15,051.95	4,955.98

The "Tax Due" in the above schedule for the year 1943 includes the unforgiven part of the 1942 tax. The "Income from Partnership" for the year 1944 includes a small amount of capital gain ($318.30 or less) in each case. (R. 23, 188.)

In determining the deficiencies here involved the Commissioner added to the income reported by the taxpayer and his deceased wife, each, 50% of the income from the Cochran & Celli partnership reported by Bernice Cochran Johnson and Winifred Cochran Irwin.[3] The correctness of the Tax Court's decision affirming this determination is the only issue for review here.

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[3] Copies of the deficiency notices were attached as exhibits to the petitions filed with the Tax Court, but are not included in the printed record.

SUMMARY OF ARGUMENT

Whether a bona fide partnership exists for federal income tax purposes is a question of fact to be determined from all the evidence. The Tax Court's findings are supported by substantial evidence and are not clearly erroneous. Neither daughter rendered any services for the partnership. Neither daughter contributed any capital which originated with her. The control of the partnership was retained by Mr. Cochran and Mr. Celli; upon their death passing to their sons, respectively. In the type of business the total partnership salaries paid were disproportionately low for the amount of its income.

ARGUMENT

There Is Substantial Evidence to Support the Tax Court's Finding That the Two Daughters Were Not Bona Fide Members of the Partnership for Federal Income Tax Purposes

This is another so-called family partnership case, of which this Court and the other appellate courts have had so many in recent years. In a great measure, these cases have been found to be mere reallocations of income among members of the immediate family group which, in many forms, the Supreme Court consistently has held cannot be availed of for purposes of reducing or avoiding federal income tax liability. See *Lucas* v. *Earl,* 281 U.S. 111; *Burnet* v. *Leininger,* 285 U.S. 136; *Helvering* v. *Clifford,* 309 U.S. 331; *Helvering* v. *Horst,* 311 U.S. 112; *Helvering* v. *Eubank,* 311 U.S. 122; *Harrison* v. *Schaffner,* 312 U.S. 579; *Helvering* v. *Stuart,* 317 U.S. 154, rehearing denied, 317 U.S. 602; *Commissioner* v. *Tower,* 327 U.S. 280; *Lusthaus* v. *Commis-*

sioner, 327 U.S. 293; *McWilliams* v. *Commissioner,* 331 U.S. 694; *Commissioner* v. *Sunnen,* 333 U.S. 591; *Commissioner* v. *Culbertson,* 337 U.S. 733. The principles particularly applicable in determining taxability of income of so-called family partnerships are settled by the decisions of the Supreme Court in *Burnet* v. *Leininger, supra; Commissioner* v. *Tower, supra; Lusthaus* v. *Commissioner, supra;* and *Commissioner* v. *Culbertson, supra,* as well as by many decisions by this Court and the other Courts of Appeals. See, among others, *Harkness* v. *Commissioner,* 193 F. 2d 655 (C.A. 9th), petition for writ of certiorari filed March 14, 1952; *Giffen* v. *Commissioner,* 190 F. 2d 188 (C.A. 9th), certiorari denied, 342 U.S. 918; *Parker* v. *Westover,* 186 F. 2d 49 (C.A. 9th); *Nordling* v. *Commissioner,* 166 F. 2d 703 (C.A. 9th), certiorari denied, 335 U.S. 817; *Battleson* v. *Commissioner,* 62 F. 2d 125 (C.A. 9th); *Quon* v. *Commissioner,* decided March 28, 1947 (1947 P-H T.C. Memorandum Decisions, par. 47,077), affirmed *per curiam,* 165 F. 2d 215 (C.A. 9th), certiorari denied, 334 U.S. 845.

The provisions of law involved are Sections 181 and 182 of the Internal Revenue Code, *supra,* which, so far as material here, provide that "Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity," and that in computing the net income of each partner he shall include in his income, whether or not distribution is made to him, his distributive share of the ordinary net income or the ordinary net loss of the partnership.

In this case, this taxpayer and his then partner, Bernardo Celli, Sr., in order to perpetuate their Chevrolet

franchise in their families and to interest their sons in staying in the business they had built up over the years, decided in 1937 to bring their sons into the business as partners. To this end the transactions outlined above were executed, including the execution of the purported partnership agreement dated January 1, 1938, by the original partners, their wives, and all of their adult children. The minor son of the taxpayer later was taken in as a partner when he became of legal age. The two Cochran sons and the two Celli sons, so far as the record shows, were actual members of the partnership during all of the periods here involved and the Commissioner has never questioned their status as such. Neither did he question the status of Mrs. Cochran or Mrs. Celli because of their community property interest under California law in the property and income of the business. However, in this proceeding he has taken the position that the taxpayer's married daughters, Bernice Cochran Johnson and Winifred Cochran Irwin, are not bona fide partners in the partnership of Cochran & Celli, and that under the facts and the law the income of the partnership reported as distributable to them for the years here involved is taxable to the taxpayer and the estate of his deceased wife as their community income. We submit there is no error in the Tax Court's decision sustaining the Commissioner's determination.

Although in this case a partnership existed which included the Cochran and Celli sons, the question whether Bernice C. Johnson and Winifred C. Irwin were bona fide members of that partnership would seem to be governed by the principles laid down by the Supreme

Court in the *Tower, Lusthaus,* and *Culbertson* cases, *supra,* and the decisions of this Court, cited above. In *Commissioner* v. *Tower, supra,* the Supreme Court said (p. 286) a partnership is created—

> when persons join together their money, goods, labor, or skill *for the purpose of carrying on a trade, profession, or business* and when there is community of interest in the profits and losses. (Italics supplied.)

The Court then went on to say that when the existence of an alleged partnership is challenged by outsiders the question arises (p. 287)—

> whether the partners really and truly intended to join together *for the purpose of carrying on business* and sharing in the profits or losses or both. *And their intention in this respect is a question of fact,* to be determined from testimony disclosed by their "agreement, considered as a whole, and by their conduct in execution of its provisions." (Italics supplied.)

It was further pointed out in that case (p. 291) that such transactions calculated to reduce family taxes should always be subject to special scrutiny, and (p. 289) that the issue is who earned the income, which issue depends upon whether the parties "really intended to carry on business as a partnership."

In *Commissioner* v. *Culbertson, supra,* the Supreme Court said (p. 740) that a partnership is "an organization for the production of income" to which each partner contributes one or both of the ingredients of income —capital or services. After quoting its statement in the *Tower* case, *supra,* to the effect that the question in that

case was whether the parties really and truly intended "to join together *for the purpose of carrying on business* and sharing in the profits or losses or both" (pp. 741-742, italics supplied), the Court emphasized (p. 742) that the question is not whether the services or capital contributed by a partner are of sufficient importance to meet some objective standard supposedly established by the *Tower* case, but whether, considering all the facts—the agreement, the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purposes for which it is used, and any other facts throwing light on their true intent—"the parties in good faith *and acting with a business purpose* intended to join together in the present conduct of the enterprise." (Italics supplied.) The Court further pointed out that the intent of the parties is a question of fact to be determined by the trier of the facts.

That to be a valid partnership for federal income tax purposes [4] the association together of individuals must be for a present and genuine business purpose is emphatically demonstrated in this Court's recent opinion in *Harkness* v. *Commissioner,* 193 F. 2d 655, petition for a writ of certiorari filed March 14, 1952. This Court's opinion in the *Harkness* case also emphasizes

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[4] A "partnership" for purposes of the Internal Revenue Code is defined in Section 3797 (a) (2) thereof, *supra,* to include a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which "any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation."

the factual nature of these so-called family partnership cases. See, also, *Battleson* v. *Commissioner,* 62 F. 2d 125 (C.A. 9th); *Nordling* v. *Commissioner,* 166 F. 2d 703 (C.A. 9th), certiorari denied, 335 U.S. 817; *Parker* v. *Westover,* 186 F. 2d 49 (C.A. 9th); *Giffen* v. *Commissioner,* 190 F. 2d 188 (C.A. 9th), certiorari denied, 342 U.S. 918. In the latter case this Court pointed out (p. 190) that "There was here no business purpose involved" in the alleged partnership.

The question here involved being a question of fact, the burden was upon the taxpayers to prove that Bernice C. Johnson and Winifred C. Irwin were bona fide members of the Cochran & Celli partnership. Cf. *Harkness* v. *Commissioner, supra; Giffen* v. *Commissioner, supra; Parker* v. *Westover, supra.* In this case the Tax Court found (R. 189): "The two Cochran daughters were included [in the partnership] because their father felt morally obligated to give them as much as he gave his sons." It further found (R. 191) that there was no bona fide intent on the part of the partners of Cochran & Celli and the two Cochran daughters, either when the partnership was formed or at any time during the taxable years here involved, that the latter "were to be joined with members of the existing partnership of Cochran & Celli for the purpose of carrying on business as a partnership"; that "Bernice Cochran Johnson and Winifred Cochran Irwin were not valid partners for income tax purposes in the business of Cochran & Celli during the years 1942, 1943 and 1944." In its opinion the Tax Court added (R. 192):

> Petitioner Joseph E. Cochran testified that the reason he made his daughters partners in the busi-

> ness was to afford them treatment equal to that he had shown his sons. While his motive was commendable, the fact remains the evidence fails to show the existence of any business purpose for bringing either of the two daughters into the partnership or that there was a bona fide intent that the two daughters be joined as partners in the business in question.

The question of intent of the parties being a question of fact to be determined from all of the evidence (*Commissioner* v. *Culbertson, supra,* pp. 743-745), it was for the Tax Court to weigh and draw its conclusions from all the evidence, conflicting or otherwise. (*United States* v. *Yellow Cab Co.,* 338 U.S. 338, 342; *United States* v. *Real Estate Boards,* 339 U.S. 485, 495-496). So long as its findings are supported by substantial evidence and are not shown to be clearly erroneous, due regard being given to the trier of the facts to judge the credibility of the witnesses they may not properly be set aside on appeal. Rule 52 (a) of the Federal Rules of Civil Procedure. *United States* v. *Gypsum Co.,* 333 U.S. 364, 395-396, rehearing denied, 333 U.S. 869; *Joe Balestrieri & Co.* v. *Commissioner,* 177 F. 2d 867, 873 (C.A. 9th); *Ruud* v. *American Packing & Provision Co.,* 177 F. 2d 538, 540 (C.A. 9th); *Grace Bros.* v. *Commissioner,* 173 F. 2d 170, 173 (C.A. 9th); *Harkness* v. *Commissioner,* 193 F. 2d 655, 658 (C.A. 9th), petition for a writ of certiorari filed March 14, 1952. "Whether the evidence would have supported a different finding by the Tax Court is a question not here presented." *Commissioner* v. *Tower,* 327 U.S. 280, 292.

We submit the taxpayers have failed to show that the Tax Court's findings in this case are clearly erroneous.

Taxpayers allege numerous errors on the part of the Tax Court (R. 201-207), both with respect to its ultimate finding that the two Cochran daughters were not bona fide partners in the Cochran & Celli partnership and with respect to its failure to find numerous evidentiary facts, which incidentally would not require a different ultimate finding by the Tax Court. In this respect the case is not unlike *Harkness* v. *Commissioner, supra.*

On brief it is admitted that whether a partnership exists for federal income tax purposes "is a question of fact to be determined, as any other fact, from all the evidence, * * *." (Br. 11.) On the other hand, and apparently overlooking the burden of proof placed upon the taxpayer in such cases, it is categorically stated that (Br. 10)—

> There just is no factual support for the Tax Court's ultimate findings that there was no bona fide intent on the part of the copartners of Cochran & Celli to accept Bernice and Winifred Cochran as members of the partnership of Cochran & Celli for the purpose of carrying on business as a partnership, and that Bernice and Winifred were not true partners during the years 1942, 1943 and 1944.

Most of the taxpayers' argument is devoted to a discussion of the legal principles enunciated by the Supreme Court in the *Tower, Lusthaus,* and *Culbertson* cases, *supra,* to which we see no reason for taking exception and to their contention that the Tax Court mis-

applied those principles to the facts of this case, which we deny. In this respect the argument is not unlike that advanced by the taxpayers in *Harkness* v. *Commissioner, supra,* and we submit, on the record here, it is equally without merit. The basis of the argument as expressed in the taxpayers' own words is that (Br. 11-12)—

> the Tax Court erroneously made its determination that no valid family partnership existed with respect to the two Cochran daughters by a strict application of the "vital services-original capital" test laid down in the *husband* and *wife* partnership cases of * * *. [*Commissioner* v. *Tower* and *Lusthaus* v. *Commissioner.*]

and that the Tax Court decided Bernice Cochran and Winifred Cochran were not valid partners for income tax purposes in Cochran & Celli for the years involved (Br. 15)—

> because they did not perform any services for the partnership or participate in the management and control of the business, and because their investments of capital in the business did not originate with them but came from their parents.

The substance of the taxpayers' argument is that the Tax Court based its ultimate finding on these facts "without proper consideration of the other material facts" as required by *Commissioner* v. *Culbertson, supra.* (Br. 16.)

The argument is without merit. In its opinion the Tax Court said R. 192):

> From a consideration of the entire record, we believe and hold that petitioners have failed to

> meet the burden of proving the reality of the partnership insofar as the Cochran daughters are concerned.

In view of the Tax Court's statement this Court would hesitate to conclude otherwise. Cf. *In re Nathan's Estate,* 166 F. 2d 422, 426-427 (C.A. 9th), citing *Bank of California* v. *Commissioner,* 133 F. 2d 428, 431, 432 (C.A. 9th). Furthermore, the weight to be given the evidence is a matter resting exclusively with the Tax Court.

It is clear from the evidence in this case, and we do not understand counsel to contend otherwise, that the Cochran daughters contributed no services to the partnership other than incidental clerical services during school vacations, apparently all before the taxable years here involved and mostly if not all before January 1, 1938, for which they were compensated as any other employee; that they took no part whatever in the management of the business at any time; and that they contributed nothing to the capital of the business other than the purported gifts from their parents, plus any undrawn profits credited to their capital accounts. As the Tax Court found (R. 189): "The two Cochran daughters were included because their father felt morally obligated to give them as much as he gave his sons." There is nothing in the record to suggest that, either at the time the agreement was made or subsequently, they were expected ever to participate in the management or control of the partnership business, or to contribute to it anything in the way of services or capital, other than the so-called gift capital plus any

undrawn earnings of the business. All of the evidence, particularly the testimony of the taxpayer (R. 94-126) and of the two daughters, Bernice (R. 146-159) and Winifred (R. 160-168) is to the contrary. Both daughters were college graduates, were married, and were engaged in the profession of teaching in California high schools. Each apparently was self-supporting during the years, but there is nothing in the record to show that either was in a position to contribute to the financial needs, if any, of the partnership business. The Tax Court found (R. 189) that under the new partnership agreement no additional capital was at any time invested in the business by any of the partners. Furthermore, there is nothing in the record to show that any additional capital contributions were contemplated, other than accumulations of undrawn partnership profits.

In the *Culbertson* case, *supra,* the Supreme Court made it clear that a contribution of either capital or services is elemental. It said (p. 740):

> A partnership is, in other words, an organization for the production of income to which each partner contributes one or both of the ingredients of income—capital or services.

Taxpayers complain because the Tax Court did not find the two Cochran daughters to be bona fide partners solely because of their contribution of so-called gift capital. (Br. 20-21.) In the *Culbertson* case, *supra* (pp. 745-748), the Supreme Court pointed out that the contribution of gift capital would not necessarily preclude the recognition of a valid family partnership

undertaking. But it was much more emphatic in saying in substance that a contribution of gift capital was not of itself sufficient to establish the existence of a valid family partnership relationship. It is only an element, although it may be an important one, in determining whether a valid partnership existed for income tax purposes. On the evidence as a whole, we are sure the Tax Court gave this factor full weight in making its disputed findings in this case. As this Court said in *Harkness* v. *Commissioner, supra* (p. 657), the primary test is one of intent, quoting with approval the following excerpt from the Tax Court's opinion in that case:

> While such lack of a capital contribution originating with themselves is not in itself determinative of the partnership status of the Harkness children, yet the presence or absence of such a capital contribution is a significant test of whether the parties intended to form a bona fide partnership.

In the present case capital clearly was an important factor in the production of partnership income. While here the evidence fails to disclose any understanding among the parties that the children would leave their share of the partnership capital in the business, there certainly is no basis in the record for concluding otherwise. There is ample warrant in the record for the Tax Court's finding (R. 190) that the bookkeeping entries evidencing the changes in partnership interests and the execution of the agreement of January 1, 1938, "were all component parts of a single plan to make all members of the Cochran family copartners in the business."

It may be, as taxpayers claim (Br. 26-27), that under the partnership agreement the Cochran daughters

could have withdrawn from the partnership and taken out of the business the book value of their capital interest, in accordance with the provisions of the agreement of January 1, 1938, but this likewise is only one of the elements to be taken into consideration by the Tax Court in determining the intent of the parties. And there is no evidence that any such action was anticipated by the other signatories to the agreement or was contemplated by either of the Cochran daughters. Their testimony was that they considered it a good investment. The same consideration applies to the withdrawals of partnership income by the Cochran daughters during 1942, 1943 and 1944, although under the partnership agreement the "managers" had the power to determine what withdrawals could be made.

Nor is there any significance to the taxpayers' contention (Br. 28) that the Cochran daughters were accepted as partners by the Celli members of the partnership. Under the agreement of January 1, 1938, the management of the partnership business was divided equally between the Cochran and Celli families and the relative family interests in the business remained unchanged. The purported division of the Cochran family investment could under the circumstances be of only small concern to the members of the Celli families. Consequently, their acceptance of Bernice and Winifred Cochran as signatories to the agreement of January 1, 1938, would not compel a reversal of the Tax Court's ultimate findings.

There is nothing in the taxpayers' statement of the facts (Br. 1-9), which is inconsistent with the Tax Court's ultimate findings, although the statement (Br.

2) that the parents believed bringing the "children" into the business as partners would give them the incentive of ownership and keep them in the business is not entirely consistent with the taxpayer's own testimony (R. 99) that he and his partner wanted to keep their "boys" in the business; and that part of the statement relating to the interest taken in the business by the Cochran girls (Br. 7-8) seems somewhat embellished when considered in connection with all the evidence in the record. Nor do the taxpayers point to any evidence in the record which would require reversal on the ground that the Tax Court's findings are clearly erroneous.

Much is made by the taxpayers (Br. 16-20, 25) of the recent decision of the Court of Appeals for the Fifth Circuit in *Alexander* v. *Commissioner,* decided March 6, 1952 (1952 P-H, par. 72,337). All that need be said of the *Alexander* case is that it affirmed a finding by the Tax Court that no valid partnership existed for tax purposes. The same result should follow here.

Taxpayer cites Mim. 6767, 1952-7 Int. Rev. Bull. 6-16, published by the Bureau of Internal Revenue on February 19, 1952. The citation of the small part of this mimeograph which appears on page 23 of the taxpayers' brief does not standing alone present a fair picture of the mimeograph, which must be considered as a whole. We submit that the mimeograph does not *require* the conclusion that a bona fide partnership exists merely because a gift of capital is made to a member of one's family and is left in the business, and is useful to the business. What this portion of the mimeograph stands for is that merely because such capital origi-

nated from a gift does not itself *require* the conclusion that the partnership will not be recognized for income tax purposes.

The mimeograph, after referring to the five principles announced in the *Culbertson* opinion, specifically provides (p. 7):

> It is emphasized that this mimeograph does not attempt either to provide a ready formula for the solution of family partnership cases or to state comprehensively all of the principles that are applicable in such cases. The matters here dealt with are accordingly to be understood in their relationship to the total fact picture in the particular case and to the basic principles of the Culbertson opinion set out above, which will not be further elaborated.

It further provides (p. 7):

> 1. *Reality of Capital Contribution.*—That a family member has acquired his partnership interest by, or as the result of, a gift, purchase, or loan from the taxpayer, and has not contributed to the partnership capital originating with himself, remains one of the factors to be considered. It should be understood, however, that the absence of "original" capital creates, rather than answers, the problem of whether an alleged partner is entitled to recognition. It presents in all cases an issue for the exercise of sound judgment on all of the facts of the particular case as to whether a partnership in good faith was intended by the parties.

The mimeograph does not lose sight of the control feature. At page 15 it deals with limited partners, and while stating there can be no hard and fast rule as to

the recognition of limited partners, it points out that limited partners generally have less control of the business. Here, the taxpayers do not contend that the two daughters were limited partners.

Nor does the mimeograph lose sight of the earner test. At page 15 it deals with the reasonableness of agreed division of profits, stating that a wholly unreasonable allocation thereof may be evidence of the absence of a bona fide partnership intent.

Where personal services are also an income-producing factor, and in an automobile agency business they are such, the amount of salaries paid to those who render services to the partnership is important. Here, the total salaries paid by the partnership range from about \$21,000 in 1942 to a little over \$17,000 in 1944. (R. 60.) The net income of the partnership in 1942, before deduction for salaries, amounted to over \$180,000, in the years 1943 and 1944 it amounted in each year to over \$200,000. (R. 76.)

In connection with the above we point to the concurring opinion of Judge Rives in *Alexander* v. *Commissioner* (C.A. 5th), decided March 6, 1952 (1952 C.C.H., par. 9232):

> I concur in the result and in most of the opinion. When the opinion speaks of examining a claimed family partnership with an eye single to determining whether in law and in fact it is a reality or a sham, I take those words to mean not merely that the partnership must be valid according to state law standards, but also that it must be tested in the light of the economic realities underlying the federal income tax law. My understanding is that every contract, whether of trust, em-

ployment, partnership, or other business relationship, in order to be recognized in attributing income, must meet the tests of economic reality according to the concepts of the federal income tax law. * * *

* * * * *

In determining "whether the partnership is real within the meaning of the federal revenue laws", (*Commissioner* v. *Tower,* 327 U.S. 290 [46-1 USTC par. 9189]) or whether "the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise", (*Culbertson* v. *Commissioner,* 337 U.S. at 742 [49-1 USTC par. 9323]), we should apply the earner test (*Lucas* v. *Earl,* 281 U.S. 111 [2 USTC par. 496]) as well as the ownership test (*Helvering* v. *Clifford,* 309 U.S. 331 [48-2 USTC par. 9393]). Generally, partnership income is the product of both personal services and capital. The division of profits according to the partnership agreement must not be patently unreasonable when compared with the actual contributions of labor and capital of the family partners. See *Woosley* v. *Commissioner* (6th Cir. 1948), 168 Fed. (2d) 330, 333 [48-1 USTC par. 9292]; *Hartz* v. *Commissioner* (8th Cir. 1948), 170 Fed. (2d) 313, 318 [48-2 USTC par. 9393].

CONCLUSION

Here, the Tax Court, after considering all of the facts, hearing the testimony, and viewing the demeanor of the witnesses, found that the two daughters were not bona fide partners for income tax purposes. There is substantial evidence to support this finding. Its decisions should be affirmed.

Respectfully submitted,

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